

Message Text

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PAGE 01 MEXICO 13393 01 OF 02 111712Z

ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03

INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02

LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04 CEA-01

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R 111656Z AUG 77

FM AMEMBASSY MEXICO

TO SECSTATE WASHDC 4172

INFO TREASURY WASHDC

C O N F I D E N T I A L SECTION 01 OF 02 MEXICO 13393

E.O. 11652: N/A

TAGS; EFIN, MX

SUBJECT: THE MEXICAN ECONOMY AT MID-YEAR

REF: STATE 180067

1. SUMMARY: THE GOM HAS MADE CONSIDERABLE PROGRESS TOWARD STABILIZING ITS ECONOMY AFTER THE TUMULTOUS EVENTS OF 1976. IT APPEARS TO HAVE MET ALL THE TARGETS FOR THE FIRST HALF AS CALLED FOR IN THE IMF PROGRAM. THERE IS INCREASING CONCERN OVER THE LACK OF PRIVATE INVESTMENT AND THE LACK OF ANY APPARENT STIMULUS TO ECONOMIC RECOVERY. THIS TELEGRAM PROVIDES PARTIAL RESPONSE TO REFTEL. FURTHER ANALYSIS WILL BE SENT SHORTLY. END SUMMARY.

2. THE GOM HAS RECEIVED A LETTER FROM IMF MANAGING DIRECTOR WITTEVEEN STATING THEY HAVE MET THE TARGETS IN THE FUND PROGRAM FOR THE FIRST QUARTER OF 1977. THEY PROBABLY MET THE TARGETS IN THE SECOND QUARTER, THOUGH ALL DATA ARE NOT AVAILABLE TO CONFIRM THIS. THE CURRENCY ISSUE OF THE BANK OF MEXICO WAS 68.6 BILLION PESOS AT END-JUNE; WELL WITHIN THE FUND PROGRAM CEILING. PUBLIC SECTOR EXTERNAL DEBT INCREASED \$641.4 MILLION IN THE FIRST

CONFIDENTIAL

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PAGE 02 MEXICO 13393 01 OF 02 111712Z

QUARTER OF THE YEAR, TO \$20,241.6 MILLION AS OF MARCH 31. NET BORROWING (DRAWDOWNS) IN THE FIRST HALF WAS PROBABLY ABOUT \$1.2 TO \$1.4 BILLION. THE PUBLIC SECTOR DEFICIT IN THE FIRST QUARTER WAS SAID TO BE ABOUT 14 BILLION PESOS. THE SECOND QUARTER DEFICIT WILL BE GREATER, BUT SHOULD NOT EXCEED 25 BILLION PESOS, FOR A FIRST HALF DEFICIT OF ROUGHLY 40 BILLIONS PESOS.

3. THE GOM HAS ALSO MADE SIGNIFICANT PROGRESS IN REDUCING THE RATE OF INFLATION. THE NATIONAL CONSUMER PRICE INDEX INCREASED 0.9 IN MAY AND 1.2 IN JUNE. THE JULY INCREASE SHOULD BE NO MORE THAN 1. THE INCREASE FOR THE FIRST HALF OF THE YEAR WAS 11.2. THE WHOLESALE PRICE INDEX INCREASED 12.5 IN THE FIRST HALF OF 1977. THE GOM ALSO MANAGED TO KEEP ITS WAGE POLICY MORE OR LESS INTACT THROUGH JULY WITH FEW WAGE INCREASES PASSING THE 10 FIGURE.

4. THE DECLINE IN INDUSTRIAL OUTPUT THAT BEGAN LAST JULY MAY HAVE BOTTOMED OUT IN FEBRUARY. THE INDUSTRIAL PRODUCTION INDEX INCREASED 14 FROM FEBRUARY TO MARCH, BUT WAS 1.6 BELOW THE YEAR EARLIER FIGURE. ALL SIX SUB-INDICES SHOWED SHARP INCREASES, BUT WITH THE EXCEPTION OF THE PETROLEUM SUB-INDEX, ALL WERE AT OR BELOW YEAR EARLIER FIGURES. THE SUB-INDEX FOR MANUFACTURES ROSE 12.7 FROM FEBRUARY TO MARCH, BUT WAS 2.5 BELOW THE YEAR EARLIER FIGURE. THE AVERAGE INDEX FOR THE FIRST QUARTER 1977 WAS 3.4 BELOW THE YEAR EARLIER FIGURE.

5. IN APRIL, THE INDUSTRIAL PRODUCTION INDEX DECLINED 3.8 FROM THE PREVIOUS MONTH BUT IT REMAINED 0.8 ABOVE THE APRIL 1976 LEVEL. THE SUB-INDEX FOR MANUFACTURES IN APRIL WAS 5.3 BELOW THE MARCH FIGURE AND 0.5 ABOVE THE APRIL

CONFIDENTIAL

PAGE 03 MEXICO 13393 01 OF 02 111712Z

1976 FIGURE. THE APRIL DECLINE IS DUE IN LARGE PART TO THE EASTER HOLIDAYS. THE YEAR TO YEAR INCREASES ARE ENCOURAGING. IT WOULD APPEAR THAT THE BOTTOM HAS BEEN REACHED. PARTIAL DATA FOR MAY INDICATES A CONTINUED RECOVERY, BUT VERY LIMITED GROWTH OF OUTPUT ON A YEAR TO YEAR BASIS.

6. THE APPARENT INCREASE IN INDUSTRIAL OUTPUT IS BEING DONE BY HIGHER UTILIZATION RATES. THERE ARE NO SIGNS OF A REVIVAL OF PRIVATE SECTOR INVESTMENT. THIS IS BECOMING AN ISSUE BETWEEN PUBLIC SECTOR OFFICIALS AND PRIVATE BUSINESSMEN, WITH SOME PUBLIC OFFICIALS CHARGING THAT THE PRIVATE SECTOR IS FAILING TO LIVE UP TO ITS PROMISES WITHIN THE ALLIANCE FOR PRODUCTION. HOWEVER, THESE CRITICISMS HAVE BEEN MUTED. THE PRESIDENT IS REPORTEDLY DEEPLY CONCERNED OVER THE LACK OF PRIVATE SECTOR INVESTMENT AND HAS ASKED U.S. BUSINESSMEN, AND PRESUMABLY MEXICAN BUSINESSMEN, FOR IDEAS AS TO HOW TO REVIVE PRIVATE INVESTMENT. THERE IS AN ACTIVE DIALOGUE BETWEEN THE PUBLIC AND PRIVATE SECTORS ON THIS MATTER IN A SPIRIT OF COOPERATION, THOUGH RESULTS THUSFAR SEEM VERY LIMITED.

7. THERE ARE A VARIETY OF REASONS FOR THE LACK OF A REVIVAL IN PRIVATE SECTOR INVESTMENT. ONE IS THAT PUBLIC SECTOR INVESTMENT IS DOWN, AND PRIVATE SECTOR INVESTMENT HAS TENDED TO FOLLOW AND COMPLEMENT PUBLIC SECTOR INFRASTRUCTURE INVESTMENT. ANOTHER IS UNCERTAINTY OVER GOM ECONOMIC POLICIES. WHILE GOM OFFICIALS TALK ABOUT A NEW INDUSTRIAL POLICY, THE DETAILS ARE VAGUE AND INADEQUATE TO GUIDE SOME INVESTORS WHO FOR THIRTY YEARS HAVE THOUGHT IN TERMS OF SUPPLYING THE DOMESTIC MARKET WITH GOODS PREVIOUSLY IMPORTED (AN IMPORT SUBSTITUTION ORIENTATION). A THIRD IS UNCERTAINTY OVER THE FUTURE EXCHANGE RATE FOR THE PESO THAT MAKES BUSINESSMEN RELUCTANT TO TAKE

CONFIDENTIAL

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PAGE 01 MEXICO 13393 02 OF 02 111721Z
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C O N F I D E N T I A L SECTION 02 OF 02 MEXICO 13393

ON DOLLAR DEBT. MOST OF THE INCREASE IN PESO CREDIT APPEARS TO HAVE BEEN USED TO PAY OFF DOLLAR DEBT. THE FOURTH IS A FEAR THAT THE LOPEZ-PORTILLO ADMINISTRATION WILL NOT BE ABLE TO COPE WITH MEXICO'S SOCIAL AND POLITICAL PRESSURES, THEREBY MAKING FOREIGN INVESTMENTS BY MEXICANS DESIRABLE.

8. MONETARY DEVELOPMENTS ARE REASONABLY ENCOURAGING, BUT ANALYSIS IS COMPLICATED BY THE USE OF TWO CURRENCIES AS WELL AS LIMITED STATISTICS. IN THE FIRST FIVE MONTHS OF THE YEAR, THE PESO COMPONENT OF THE MONEY SUPPLY DECLINED 9.4 BILLION PESOS. WHEREAS PESO-DENOMINATED CREDIT FROM THE BANKING SYSTEM INCREASED 11.8 BILLION PESOS, TIME DEPOSITS WERE UP 15 BILLION PESOS. THIS APPARENT SHIFT FROM CURRENCY AND DEMAND DEPOSITS IS SEASONAL, AND NOT OUT OF LINE WITH DEVELOPMENTS IN THE TWO PREVIOUS YEARS. THE YEAR TO YEAR INCREASE IN THE MONEY SUPPLY HAS DECLINED

FROM 31 IN JANUARY TO 28.7 IN MAY.

9. THE DOLLAR COMPONENT OF THE MONETARY SYSTEM CONTINUES TO EXPAND. DOLLAR DEMAND DEPOSITS WERE UP \$69 MILLION IN THE FIRST FIVE MONTHS OF THE YEAR. DOLLAR DENOMINATED CREDIT INCREASED \$709.5 MILLION, WHEREAS DOLLAR LIABILITIES

CONFIDENTIAL

CONFIDENTIAL

PAGE 02 MEXICO 13393 02 OF 02 111721Z

(EX-DEMAND ACCOUNTS) WERE UP 1,279 MILLION. OF THE LATTER AMOUNT EXTERNAL LOANS TO THE BANKING SYSTEM ACCOUNTED FOR \$575.4 MILLION. THE RESIDUAL IN THE DOLLAR EQUATION IS \$500.5 MILLION.

THIS PRESUMABLY WOULD SHOW UP IN OTHER ASSETS THAT ARE NOT INCLUDED IN THE DATA PUBLISHED BY THE BANK OF MEXICO.

PARTIAL DATA ON BANK LIABILITIES THROUGH JUNE SHOW CONTINUED INCREASES IN BOTH PESO AND DOLLAR LIABILITIES WITH THE LATTER UP 11.9 FROM END-APRIL AND THE FORMER UP 1.6.

THIS PARTIAL DATA WOULD INDICATE THAT THE INTEREST RATE REFORM OF LATE MAY DID NOT INDUCE A SHIFT FROM DOLLARS TO PESOS, NOR DOES IT APPEAR TO HAVE BROUGHT ABOUT A SHIFT FROM CURRENCY TO DEPOSITS. THE PRESIDENT REMAINS MOST CONCERNED WITH DOLLARIZATIONS AND IS INTRODUCING ADDITIONAL MEASURES TO COPE WITH THE PROBLEM. FINANCE SUB-GROUP WAS TOLD THAT THERE WAS A SHIFT FROM THE MORE LIQUID TIME DEPOSITS TO THE LONGER MATURITIES.

10. THE CURRENT ACCOUNT DEFICIT FOR THE FIRST QUARTER OF 1977 HAS BEEN REVISED DOWNWARD TO ABOUT \$190 MILLION, BUT NOT YET PUBLISHED AS SUCH. THE SECOND QUARTER CURRENT ACCOUNT DEFICIT IS LIKELY TO BE AROUND \$300 MILLION. "ERRORS AND OMISSIONS" IN THE FIRST QUARTER WERE \$215 MILLION. THIS WOULD INDICATE THAT THERE WERE NET PRIVATE CAPITAL OUTFLOWS IN THIS PERIOD. ACCOUNTING FOR THE PROCEEDS FROM THEIR FUND DRAWING IN JANUARY AND REPAYMENT OF THE \$150 MILLION FED SWAP IN FEBRUARY WOULD REDUCE THIS BY ABOUT \$30 MILLION. ASSUMING A CURRENT DEFICIT OF \$300 MILLION IN THE SECOND QUARTER, NET PUBLIC SECTOR BORROWING OF \$500 MILLION AND A RESERVE INCREASE OF \$15 MILLION, OR \$165 MILLION, TAKING INTO ACCOUNT REPAYMENT OF THE TREASURY SWAP, PRIVATE CAPITAL OUTFLOWS SLOWED IN THE SECOND QUARTER.

CONFIDENTIAL

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PAGE 03 MEXICO 13393 02 OF 02 111721Z

11. APPARENTLY THESE CAPITAL OUTFLOWS ARE TAKING THE FORM OF REPAYMENTS OF PRIVATE SECTOR EXTERNAL DEBT. IT APPEARS

THAT THE INCREASE IN PESO CREDIT IN THE FIRST FIVE OR
SIX MONTHS OF THE YEARS HAS BEEN USED TO REDUCE DOLLAR
DEBT. THUS, IT IS POSSIBLE THAT SOME PRIVATE CAPITAL HELD
ABROAD HAS BEEN REPATRIATED, BUT NOT IN AN AMOUNT ADEQUATE
TO OFFSET THE RUN OFF OF PRIVATE DEBTS TO FOREIGN
FINANCIAL INSTITUTIONS. LUCEY

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